

slightly below targeted measures while Cash Flow target was exceeded. Our 2001 EBIT performance was negatively impacted by a one-time early retirement and severance charge due to corporate restructuring, which was not included in our target. For 2000, our Operating Margin and EBIT performance fell slightly below targeted measures while Cash Flow and RONIC targets were exceeded. Our 2000 EBIT performance was negatively impacted by a one-time early retirement and severance charge related to the merger of Illinova and Dynegy, which was not included in our target.

In 1999, our operations were divided into four reportable segments: Customer Service, Wholesale Energy, Nuclear and Other. The business groups and their principal services in 1999 were as follows:

- *Customer Service Business Group*—transmission, distribution and sale of electric energy; distribution, transportation and sale of natural gas in Illinois.
- *Wholesale Energy Business Group*—fossil-fueled electric generation in Illinois, wholesale electricity transactions throughout the United States and dispatching activities.
- *Nuclear Generation Business Group*—nuclear-fueled electric generation in Illinois.
- *Other*—This category included the financial support functions such as accounting, finance, corporate performance, audit and compliance, investor relations, legal, corporate development, regulatory, risk management and tax services. Also included in this group were specialized support functions, including information technology, human resources, environmental resources, purchasing and materials management and public affairs.

Customer Service – Transmission, Distribution and Sale of Electric Energy and Gas. The Customer Service Business Group derived its revenues through regulated tariffs. Its source of electricity was the Wholesale Energy Business Group and the Nuclear Business Group. Electricity was provided to the Customer Business Group at a fixed 2.9 cents per kilowatt-hour for the first nine months of 1999. During the last quarter of 1999 electricity was provided to the Customer Service Business Group at the power purchase agreement price between Illinois Power and DMG.

Wholesale Energy. The Wholesale Energy Business Group derived its revenues by providing electricity primarily to the Customer Service Business Group. Electricity was provided at 2.9 cents per kilowatt-hour for the nine months ended September 30, 1999. During the last quarter of 1999, electricity was provided at the power purchase agreement price between Illinois Power and DMG.

Nuclear. During 1999, the Nuclear Business Group revenues consisted of collections from customers under tariff riders to fund the decommissioning trust and 2.9 cents per kilowatt-hour generated and sold to the Customer Service Business Group. The nuclear assets were sold to AmerGen on December 15, 1999.

Other. Included in this category were the Financial Business Group, the Support Services Business Group and other corporate functions. These segments did not individually meet the minimum threshold requirements for separate disclosure.

For additional information, please read "Note 13—Segments of Business" to the audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2001.

Twelve-Month Periods Ended December 31, 1999, 2000 and 2001

Electric Operations. For the years 1999 through 2001, electric revenues, including interchange, decreased 29% and the gross electric margin decreased 52% as follows:

(Millions of Dollars)	2001	2000	1999
Electric revenues	\$1,137.1	\$1,189.4	\$1,178.6
Interchange revenues7	2.7	420.2
Fuel cost & power purchased	(661.8)	(729.3)	(612.3)
Electric margin	<u>\$ 476.0</u>	<u>\$ 462.8</u>	<u>\$ 986.5</u>

The components of annual changes in electric revenues were:

(Millions of Dollars)	2001	2000
Price	\$(65.4)	\$(39.8)
Volume and other	13.1	50.6
Revenue increase (decrease)	<u>\$(52.3)</u>	<u>\$ 10.8</u>

2001. Electric revenues including interchange sales were lower in 2001 due to industrial customers purchasing energy from alternative retail electric suppliers and a downturn in economic conditions.

2000. Electric revenues excluding interchange sales remained relatively constant. The significant reduction in interchange revenues is due to the transfer of the fossil generating units to Illinova in October 1999, the sale of the Clinton Power Station, referred to as "Clinton," to AmerGen Energy Company, referred to as "AmerGen," in December 1999 and our strategic focus on the transmission and distribution business.

The cost of meeting our system requirements was reflected in fuel costs and power purchased. Changes in these costs are detailed below:

(Millions of Dollars)	2001	2000
Fuel for electric plants	\$ —	\$(191.2)
Power purchased	(67.5)	308.2
Total increase (decrease)	<u>\$(67.5)</u>	<u>\$ 117.0</u>

System load requirements, generating unit availability, fuel prices, purchased power prices, resale of energy to other utilities, the transfer of our wholly owned fossil generating assets to Illinova on October 1, 1999 and the sale of Clinton to AmerGen caused changes in these costs.

2001. The decrease in power purchased cost was primarily due to lower customer demand related to the industrial downturn and fewer units purchased due to industrial customers choosing alternative energy suppliers, partially offset by increased power purchase agreement per unit costs.

2000. With the transfer of the fossil generating units to Illinova and the sale of Clinton to AmerGen, we no longer incur any fuel costs for electric plants. Conversely, a significant increase occurs in power purchases due to the power purchase agreements in effect with DMG and AmerGen, which simulate fuel cost and operating expenses.

Gas Operations. For the years 1999 through 2001, gas revenues, including transportation, increased 57%, while the gross margin on gas revenues increased 3% as follows:

(Millions of Dollars)	2001	2000	1999
Gas revenues	\$ 469.8	\$ 388.0	\$ 298.9
Transportation revenues	6.8	5.5	5.5
Gas cost	(332.8)	(252.7)	(165.1)
Gas margin	<u>\$ 143.8</u>	<u>\$ 140.8</u>	<u>\$ 139.3</u>

(Millions of Therms. Unless Otherwise Noted)	2001	2000	1999
Therms sold	539	574	553
Therms transported	246	259	270
Total delivered	<u>785</u>	<u>833</u>	<u>823</u>
Average cost per therm delivered	53.9 cents	48.3 cents	26.8 cents

Changes in the cost of gas purchased for resale were:

(Millions of Dollars)	2001	2000
Gas purchased for resale:		
Cost	\$ 29.6	\$127.7
Volume	(30.0)	4.0
Gas cost recoveries	80.5	(44.1)
Total increase	<u>\$ 80.1</u>	<u>\$ 87.6</u>

The 2001 and 2000 increase in gas costs was attributable to market conditions that caused natural gas prices to reach unprecedented highs partially offset by the effects of the Uniform Gas Adjustment Clause.

Other Expenses. A comparison of significant increases (decreases) in other operating expenses, maintenance, and depreciation and amortization for the last two years is presented in the following table:

(Millions of Dollars)	2001	2000
Other operating expenses	\$ (1.2)	\$(323.4)
Retirement and severance expense	(15.7)	31.0
Maintenance	(3.1)	(50.1)
Depreciation and amortization	3.9	(50.0)

The decrease in operating and maintenance expense for 2001 is primarily due to incremental operating efficiencies, while the decrease in 2000 is primarily due to the transfer of the fossil generating assets to Illinova on October 1, 1999 and the sale of Clinton to AmerGen on December 15, 1999.

In 2001, we offered an early retirement/severance program to effectuate a reorganization. In 2000, we offered an early retirement/severance program related to the Dynegy-Illinova merger.

Depreciation and Amortization. Depreciation and amortization increased from \$77.6 million in 2000 to \$80.9 million in 2001 primarily as a result of plant additions in the ordinary course of business. The decrease in depreciation and amortization from \$151.8 million in 1999 to \$77.6 million in 2000 was attributable to the transfer of our fossil generating assets in 1999.

Amortization of Regulatory Assets. Amortization of regulatory assets increased slightly from \$50.6 million in 2000 to \$51.2 million in 2001. The increase in amortization of regulatory assets from \$26.4 million in 1999 to \$50.6 million in 2000 was attributable to improved financial performance in 2000, which allowed additional amortization within the provisions of the return on equity collar.

Operating Income. Operating income increased from \$156.0 million in 2000 to \$166.5 million in 2001 primarily as a result of incremental operating efficiencies and differences in two separate early retirement/severance programs. The decrease in operating income from \$217.7 million in 1999 to \$156.0 million in 2000 was attributable to the transfer of our fossil generating assets and Clinton Power Station in 1999.

Other Income and Deductions – Net. For year 2001, total other income and deductions—net increased by \$4.8 million from \$116.7 million to \$121.5 million primarily due to favorable results from an insurance investment and a litigation settlement, partially offset by a decrease in interest income from affiliates and reduced revenues from non-utility support services. The increase in 2000 of other income and deductions—net was attributable to interest on the Illinova note offset by increased taxes related to non-utility income.

Interest Charges. Total interest charges, including Allowance for Funds Used During Construction, decreased \$16.0 million and \$6.4 million in 2001 and 2000, respectively, primarily due to the redemption of Transitional Funding Trust Notes, and lower interest rates on variable Mortgage Bonds. For additional information, please read “Note 9—Long-Term Debt” to the audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2001.

Nine-Month Periods Ended September 30, 2001 and 2002

	Nine months ended September 30,	
	2002	2001
	(In Millions)	
Electric Sales Revenues—		
Residential	\$ 348	\$ 346
Commercial	261	257
Commercial-distribution*	—	1
Industrial	217	217
Industrial-distribution*	4	2
Other	29	30
Revenues from ultimate consumers	859	853
Interchange	7	1
Transmission/Wheeling	30	33
Total Electric Revenues	<u>\$ 896</u>	<u>\$ 887</u>
Electric Sales (In kWh)—		
Residential	4,342	4,160
Commercial	3,334	3,308
Commercial-distribution*	2	39
Industrial	4,719	4,754
Industrial-distribution*	1,921	1,937
Other	282	285
Sales to ultimate consumers	14,600	14,483
Interchange	1	2
Total Electric Sales	<u>14,601</u>	<u>14,485</u>
Gas Sales Revenues—		
Residential	\$ 161	\$ 237
Commercial	58	91
Industrial	18	38
Other	2	4
Revenues from ultimate consumers	239	370
Transportation of customer-owned gas	—	5
Sales to affiliates	8	9
Total Gas Revenues	<u>\$ 247</u>	<u>\$ 384</u>
Gas Sales (In Therms)—		
Residential	214	225
Commercial	90	99
Industrial	41	52
Sales to ultimate consumers	345	376
Transportation of customer-owned gas	180	185
Total gas sold and transported	525	561
Sales to affiliates	20	17
Total Gas Delivered	<u>545</u>	<u>578</u>

* Distribution of customer-owned energy.

Nine-Month Periods Ended September 30, 2001 and 2002

Operating revenues in 2002 decreased \$128 million primarily due to decreased gas prices, lower transportation revenues, unfavorable weather compared to last year and decreased late payment charges. Electric revenues reflected slightly higher sales volume due to favorable weather and resolution of a contingent liability for a bulk power billing dispute offset by a 5% residential rate reduction effective May 1, 2002.

Operating expenses, excluding income taxes, decreased \$126 million in 2002 compared to 2001 primarily due to significantly lower market prices for natural gas purchases, lower general taxes, and lower gas volumes purchased.

Depreciation and amortization was \$61 million in 2002 and 2001.

Amortization of regulatory assets was \$38 million in 2002 and 2001.

Operating income decreased from \$147 million in 2001 to \$138 million in 2002 primarily as a result of unseasonably mild heating season weather in 2002, a general economic downturn and a 5% residential rate reduction effective May 1, 2002.

Other income decreased from \$94 million to \$83 million and includes interest income of \$128 million in 2002 as compared to \$127 million in 2001. Miscellaneous—net in 2001 included favorable insurance and litigation settlements while 2002 also included a favorable litigation settlement. Interest expense period-to-period decreased \$11 million reflecting lower average long-term debt balances coupled with lower interest charges on short-term debt.

Cash flow from operating activities totaled \$219 million for the nine-month period ended September 30, 2002, compared to \$179 million reported in the 2001 period. Changes in operating cash flow reflect the operating results previously discussed herein. Additional cash flow changes for 2002 resulted primarily from accelerated interest payments on the Illinova note, partially offset by the prepayment of some gas purchases. Cash flow in 2001 was affected by higher priced natural gas purchases and income taxes paid.

Liquidity and Capital Resources

Available Credit Capacity, Liquidity and Debt Maturities

Sources of Liquidity. We are currently satisfying our capital requirements primarily with cash from operations, cash on hand and interest income under our \$2.3 billion intercompany note receivable from Illinova.

Due to our non-investment grade credit ratings and other factors, including our relationship with Dynegy, we do not have access to the commercial paper markets, and our access to the capital markets is limited. Given these facts, we expect to continue to rely primarily on cash from operations, cash on hand, cash from asset sales and interest income under our intercompany note receivable to meet our near-term obligations.

Available Credit Capacity. On May 17, 2002, we exercised the "term-out" provision contained in our \$300 million 364-day revolving credit facility, which was scheduled to mature on May 20, 2002. In connection with this conversion, we borrowed the remaining \$60 million available under this facility. The exercise of the "term-out" provision converted the facility to a one year term loan that matures in May 2003. Borrowings of \$300 million were outstanding under this loan at September 30, 2002. We do not expect to repay this loan prior to its maturity unless a new revolving credit facility is secured on mutually acceptable terms.

Because we have no borrowing capacity currently available under the bank facility discussed above, our future operations could be adversely affected. For example, a significant portion of our operating cash flows will

be dedicated to the payment of principal and interest on indebtedness and will not be available for other purposes. Further, because of our non-investment grade credit rating and other factors, our ability to obtain additional financing for working capital, capital expenditures, acquisitions, general corporate and other purposes could be limited. Please read "Credit Rating Discussion" below for additional factors impacting our financial flexibility. Please also read the risk factors titled "Our significant leverage could have a material adverse effect on our financial condition and results of operations" and "Our sources of cash may be insufficient to satisfy our ongoing liquidity requirements." Our ability to meet debt service obligations and reduce total indebtedness will be dependent upon future performance and the other factors described herein, many of which are beyond our control.

We had one standby bond purchase facility in the aggregate principal amount of \$152 million that provided credit enhancement for \$150 million of Illinois Development Finance Authority 1997 Series A, B and C bonds, referred to as the "Pollution Control Bonds," along with one month's interest of approximately \$2 million, for which our Pollution Control Series P, Q and R Mortgage Bonds were issued without coupon and pledged to secure payment on the Pollution Control Bonds. On April 9, 2002, the indenture for that financing was amended to incorporate an additional interest rate setting mechanism, the auction rate mode. After the indenture was amended, the Pollution Control Bonds were reissued without further change. The auction rate mode does not require the use of a standby purchase facility, allowing the standby bond purchase facility to expire without consequence.

Uses of Liquidity. Our \$96 million Mortgage Bonds, which matured on July 15, 2002, were redeemed using \$85 million of prepaid interest on the Illinova note and \$11 million of working capital.

On March 28, 2002, we completed a solicitation of consents from our preferred stockholders to amend our Restated Articles of Incorporation to eliminate a provision restricting the amount of unsecured indebtedness that we could issue or assume. In addition, Illinova completed a tender offer pursuant to which it acquired 662,924 shares, or approximately 73%, of our preferred stock. The New York Stock Exchange has taken action to delist each of the series of preferred stock that were subject to the tender offer and previously listed thereon. On March 29, 2002, we amended our Restated Articles of Incorporation to eliminate the restriction on incurring unsecured indebtedness. Certain charges incurred in connection with the consent solicitation, approximately \$1 million in the aggregate, were paid by us. These charges are reflected as an adjustment to Retained Earnings in our balance sheet as of September 30, 2002 included in our quarterly report on Form 10-Q.

Debt Maturities and Liquidity Plan. We have significant debt maturities through December 2003. These maturities include the May 2003 maturity of our \$300 million term loan, the August 2003 and September 2003 Mortgage Bond maturities of \$100 million and \$90 million, respectively, and quarterly payments of approximately \$22 million on Transitional Funding Trust Notes issued by the Illinois Power Special Purpose Trust (which payments are made with cash to be set aside from customer billings). We are required to make these same quarterly payments of approximately \$22 million on our Transitional Funding Trust Notes through 2008, and have a payment of up to \$81 million due on our Tilton lease financing in the third quarter of 2004. Pursuant to this financing, which is treated as an operating lease for accounting purposes and a capital lease for tax purposes, we lease, and then sublease to DMG, four gas turbines associated with a power plant located in Tilton, Illinois. At the expiration of the lease, we have an option to purchase the gas turbines. If we do not purchase the gas turbines, the turbines will be sold. We will be responsible for any shortfall if the sale proceeds are less than \$81 million, up to our minimum residual value guarantee on the lease of 86% of the \$81 million payment due, or \$69.6 million. Please read the risk factor titled "Our significant leverage could have a material adverse effect on our financial condition and results of operations." We are developing a plan to improve our liquidity in order to meet our near-term debt maturities and provide for ongoing operations and necessary capital expenditures. The plan includes:

- the completion of various financing transactions, including this offering; while there are other restrictions and limitations to issuing mortgage debt, as of September 30, 2002 and prior to this

offering, we had sufficient property and refunded bond capacity to issue up to \$974 million of additional Mortgage Bonds;

- the completion of the sale of our electric transmission system to Trans-Elect for \$239 million before income tax and other transaction expenses; the net proceeds of this sale are expected to be approximately \$180 million, with closing expected during the first half of 2003; and
- the refinancing of our \$300 million term loan, and the successful negotiation of a new bank credit facility on terms acceptable to us.

We believe that we have sufficient liquidity to meet our debt maturities and other obligations through the first quarter 2003. However, our long-term liquidity depends upon successful completion of our liquidity plan.

Our ability to successfully execute these initiatives is subject to a number of risks including factors beyond our control. The factors include, among others, the timeliness and ability to obtain regulatory approvals, the receptiveness of the capital markets to this offering and the continued negative effects of our relationship with Dynegy. If we are unable to successfully execute these initiatives, we would require additional liquidity support from Dynegy, to the extent available and subject to receipt of any required regulatory approvals, in order to satisfy our debt maturities and other obligations as they come due. Please read “—Relationship with Dynegy” and the risk factor titled “Our relationship with Dynegy and its financial condition subjects us to potential risks that are beyond our control” above for a discussion of the issues currently facing Dynegy and its potential inability to provide such additional liquidity support.

Capital Asset Program

Construction expenditures for the nine months ended September 30, 2002 were approximately \$102 million. We estimate that we will spend approximately \$38 million on construction for the fourth quarter of 2002. Construction expenditures for the nine months ended September 30, 2001, were \$105 million, and for the year ended December 31, 2001, were \$149 million. Construction expenditures consist of numerous projects to upgrade and maintain the reliability of our electric and gas distribution and transmission systems, add new customers to the system and prepare for a competitive environment. Our construction expenditures for 2003 through 2006 are expected to total approximately \$600 million. Additional expenditures may be required during this period to accommodate the transition to a competitive environment, environmental compliance, system upgrades and other costs that cannot be determined at this time.

Affiliate Transactions

For a discussion of our affiliate transactions, please read “Certain Relationships and Related Transactions.”

Credit Rating Discussion

Credit ratings impact our ability to obtain short-term and long-term financing, the cost of such financing and the execution of our commercial strategies. In determining credit ratings, the rating agencies consider a number of factors. Quantitative factors that are given significant weight include, among other things, earnings before interest, taxes, and depreciation and amortization, referred to as EBITDA; operating cash flow; total debt outstanding; off balance sheet obligations and other commitments; fixed charges such as interest expense, rent, or lease payments; payments to preferred stockholders; liquidity needs and availability; and various ratios calculated from these factors. Qualitative factors include, among other things, predictability of cash flows, business strategy, industry position and contingencies. In determining our credit ratings, the rating agencies also consider the liquidity position and credit ratings of Dynegy, our indirect parent company. Although these factors are among those considered by the rating agencies, each rating agency may utilize different factors and may calculate and weigh each factor differently.

The challenges faced by Dynegy over the past several months have resulted in numerous credit rating downgrades of Dynegy and its subsidiaries, including us, by the three major credit rating agencies. The ratings on the senior unsecured debt issued by Dynegy Holdings, Dynegy's primary financing subsidiary, are all well below investment grade and remain on negative watch for further downgrades by all three major credit rating agencies. Most recently, on November 26 and December 9, 2002, Standard & Poor's and Moody's, respectively, lowered their credit ratings for Dynegy and its subsidiaries, including us and our Mortgage Bonds. In taking their ratings actions, these agencies cited concerns over, among other things, the level of cash flows that the restructured Dynegy will be able to generate relative to its significant financial leverage, its ability to address its debt obligations coming due over the next several years and uncertainties surrounding ongoing investigations and litigation and the re-audit of Dynegy's 1999-2001 financial statements. As of the date of this offering memorandum, these senior unsecured debt ratings for Dynegy Holdings were CCC+, Caa2 and B by Standard & Poor's, Moody's and Fitch, respectively. Similarly, the ratings on our Mortgage Bonds have been downgraded to below investment grade by all three major credit rating agencies and remain on negative watch for further downgrades by all three major credit ratings agencies. As of the date of this offering memorandum, the ratings on our Mortgage Bonds were B, B3 and BB- by Standard & Poor's, Moody's and Fitch, respectively.

As of the date hereof, our credit ratings, as assessed by the three major credit rating agencies, were as follows:

	Standard & Poor's	Moody's	Fitch
Senior secured debt	B	B3	BB-
Senior unsecured debt	*	Caa1	B
Preferred stock	CCC	Ca	CCC
Transitional funding trust notes	AAA	Aaa	AAA

• Not rated.

A further downgrade of the outstanding indebtedness of Dynegy Holdings could likely result in a similar downgrade of our indebtedness, including the Offered Bonds. Our non-investment grade status precludes our use of Form S-3 under the Securities Act, limits our ability to refinance our debt obligations as they become due and adversely affects our access to the capital markets. Our non-investment grade status also will likely increase the borrowing costs incurred in connection with any such actions. Our financial flexibility will likewise be reduced as a result of, among other things, restrictive covenants and other terms typically imposed on non-investment grade borrowers. In addition, it is currently anticipated that the terms of our refinanced or new credit facility will be more stringent than the terms contained in our existing facility, and that such facility may be secured by Mortgage Bonds or an interest in our assets that is equal in right of payment with the Offered Bonds. In addition, we have been requested to provide letters of credit or other credit security to support certain business transactions, including some of our purchases of natural gas and natural gas transportation. Because of the effect of Dynegy's credit ratings on our credit ratings, we cannot guarantee that our current credit ratings will be maintained or that the negative effects of our non-investment grade status will be reduced.

Financial Obligations and Commercial Commitments

We have entered into various financial obligations and commitments in the course of our ongoing operations and financing strategies. Financial obligations are considered to represent known future cash payments that the enterprise is required to make under existing contractual arrangements, such as debt and lease agreements. These obligations may result from both general financing activities as well as from commercial arrangements that are directly supported by related revenue-producing activities. Financial commitments represent contingent obligations of the enterprise, which become payable only if certain pre-defined events were to occur, such as funding financial guarantees.

The following table provides a summary of our financial obligations and commercial commitments as of December 31, 2001. This table includes cash obligations related to principal outstanding under existing debt arrangements, decommissioning charges, operating leases and unconditional purchase obligations.

FINANCIAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

		Payments due by period					
Cash obligations*	Total	2002	2003	2004	2005	2006	Thereafter
		(\$ in millions)					
Long-Term Debt ⁽¹⁾⁽²⁾	\$1,180.3	\$ 95.7	\$190.0	\$ —	\$ 70.0	\$ —	\$ 824.6
Transitional Funding Trust Notes ⁽³⁾	604.8	86.4	86.4	86.4	86.4	86.4	172.8
Operating Leases ⁽⁴⁾	5.8	.8	.7	.7	.7	.7	2.2
Decommissioning Charges ⁽⁵⁾	14.9	5.0	5.0	4.9	—	—	—
Unconditional Purchase Obligations ⁽⁶⁾	1,091.8	400.1	361.4	323.1	2.2	2.2	2.8
Total Contractual Cash Obligations	\$2,897.6	\$588.0	\$643.5	\$415.1	\$159.3	\$89.3	\$1,002.4

* Cash obligations herein are not discounted and do not include related interest or accretion.

- (1) Reflects indebtedness issued pursuant to our Mortgage, under which we generally are able to issue debt secured by the Mortgage provided that (a) our "adjusted net earnings" are at least two times our "annual interest requirements," and (b) the aggregate amount of indebtedness secured by the Mortgage does not exceed three-quarters of the original cost of the property subjected to the lien of the Mortgage, reduced to reflect property that has been retired or sold. We also generally can issue indebtedness in exchange for repurchased and retired indebtedness independent of whether these two tests are met. Aggregate principal outstanding under our Mortgage Bonds approximated \$1.2 billion at December 31, 2001, bearing interest ranging from 1.4% to 7.5% per annum. A \$95.7 million Mortgage Bond issue matured in July 2002. We also had one standby bond purchase facility in the aggregate principal amount of approximately \$150 million along with one-month's interest of approximately \$2 million, which provided a backstop to the short-term remarketing of our variable rate bonds. The facility related to our Pollution Control Series P, Q, R Mortgage Bonds. We paid fees of .10% per annum on the full amount of the facility. In the event of the inability to remarket the bonds during an interest reset, a bank syndicate would be obligated to purchase all un-remarketed bonds. We would be required to purchase all un-remarketed bonds and pay the associated fees ratably over a five-year period. On April 9, 2002, the indenture for that financing was amended to incorporate an additional rate setting mechanism, the auction rate mode. Please read "Liquidity and Capital Resources—Available Credit Capacity, Liquidity and Debt Maturities" above for further discussion.
- (2) Does not reflect outstanding borrowings under our \$300 million revolving bank credit facility, which was converted to a term loan in May 2002 and has since been considered short-term debt.
- (3) Reflects the balance of \$864 million of Transitional Funding Trust Notes issued by Illinois Power Special Purpose Trust in December 1998 as allowed under the Illinois Electric Utility Transition Funding Law in P.A. 90-651. Per annum interest on these notes averages approximately 5.4%. We are retiring the principal outstanding under these notes through quarterly payments of \$21.6 million through 2008.
- (4) Our primary operating lease reflected above relates to our Material Distribution Facility, which is a commercial property lease for our storage warehouse. This lease expires in 2009. We also have a lease/sublease agreement on four gas turbines located at the Tilton site. We entered into the five-year lease, which is treated as an operating lease for accounting purposes and as a capital lease for tax purposes, beginning in September 1999 with the option for renewal for two additional years. Beginning in October 1999, we subsequently sublet the turbines to DMG. Therefore, the impact of this lease is not reflected in the above table. We are providing a minimum residual value guarantee on the lease of approximately \$69.6 million. At the expiration of the lease agreement, we have the option to purchase the gas turbines. If we do not purchase the gas turbines, the turbines will be sold. We will be responsible for any shortfall if the sale proceeds are less than \$81 million up to our minimum residual value guarantee on the lease of 86% of the \$81 million payment due, or \$69.6 million.
- (5) Reflects decommissioning charges associated with our former Clinton facility. For additional information, please read "Note 3—Clinton Impairment, Quasi-Reorganization and Sale of Clinton" to the audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2001.
- (6) Reflects an unconditional power purchase obligation between us and DMG. The agreement requires us to compensate DMG for capacity charges over the next three years at a total contract cost of \$974.7 million. We also have contracts on six interstate pipeline companies for firm transportation and storage services for natural gas. These contracts have varying expiration dates ranging from 2002 to 2008, for a total cost of \$82.4 million. We also enter into obligations for the reservation of natural gas supply. These obligations generally range in duration from one to five months and require us to pay reservation charges. The cost of the agreements is \$34.7 million. As of September 30, 2002, these contracts now have varying expirations dates ranging from 2003 to 2012 for a total cost of \$122 million. The costs associated with these contracts are a component of our revenue requirements under our rate-making process.

In addition to the unconditional purchase obligations described above, we have entered into contracts that stipulate fixed payments for the supply of energy as well as variable payments for the reimbursement of operating costs. The costs associated with these arrangements are a component of our revenue requirements under our rate-making process.

Contingent Financial Obligations We have \$1.1 million in surety bonds outstanding as of December 31, 2001, which expire in 2003.

Pension Plan Assets

As a result of general declines in the financial markets, the return on pension plan assets for the Dynegy Inc. Master Retirement Trust, which includes the assets related to our pension plans, was a negative 14% for the nine months ended September 30, 2002. These negative returns have reduced plan assets during 2002 to levels that will likely fall below projected plan obligations at year end. If the plan is underfunded at year end, we have two alternatives. The first alternative is to contribute cash to the plan in an amount equal to the underfunded amount. The second alternative is to establish a liability equal to the underfunded amount and prepaid pension asset with the offset being an after-tax reduction in shareholder's equity. Determination of any underfunded amount will be made at year end 2002 and will be dependent on the actual return on pension plan assets for 2002, the discount rate assumption, which depends on year-end interest rates, and actual participant numbers. We do not believe that any such determination will have a material effect upon our financial condition and results of operations.

Dividends

Under our Restated Articles of Incorporation, common stock dividends are subject to the preferential rights of the holders of preferred and preference stock. We are also limited in our payment of dividends by the Illinois Public Utilities Act, which require retained earnings equal to or greater than the amount of any proposed dividend declaration or payment. The Federal Power Act precludes declaration or payment of dividends by electric utilities "out of money properly stated in a capital account." In addition, the ICC generally may prevent us from paying dividends if it determines that our capital is or would be impaired. At September 30, 2002, we had retained earnings of approximately \$368 million. Our retained earnings balance is expected to be sufficient during 2002 to support payment of all scheduled preferred dividends. For the nine months ended September 30, 2002, we have paid preferred stock dividends of \$1.7 million. On March 28, 2002, we declared and paid common stock dividends of \$0.5 million to Illinova. Additionally, the ICC's October 23, 2002 order relating to our netting agreement with Dynegy prohibits us from declaring and paying any dividends on our common stock until such time as our Mortgage Bonds are rated investment grade by both Moody's and Standard & Poor's and requires that we first obtain approval for such payment from the ICC.

The ICC's October 2002 order authorized us to provide funds to Illinova to enable it to make interest payments due in February and August 2003 and February 2004 on its senior notes, but only if and only to the extent that Illinova is unable to obtain the necessary funds from Dynegy or another source. The amount of each of these three scheduled interest payments is approximately \$3.6 million. With respect to the February 2003 interest payment on Illinova's senior notes, the ICC order authorizes us to advance funds directly to DTC, for the account of Illinova, for the payment of interest on the senior notes. Illinova is to repay us within 30 days with interest at an annual rate of 7.5%. If Illinova fails to repay us within 30 days, we may rely on the netting agreement to offset this unpaid amount against other amounts we owe to Dynegy. With respect to the August 2003 and February 2004 interest payments, the ICC order authorizes us to provide funds to Illinova by repurchasing shares of our 7.75% series \$50 par value preferred stock, which is callable by us in whole or in part at any time after July 1, 2002. Illinova holds approximately 95% of the shares of our 7.75% series preferred stock.

Relationship With Dynegy

We are an indirect wholly owned subsidiary of Dynegy. Dynegy has recently experienced a number of events that have had a severely negative effect on its operating results, liquidity and public confidence in its ability to meet its debt and other obligations and its long-term business strategy, all of which are reflected in continuous declines in the market price of Dynegy's debt and equity securities. Also weighing on public

confidence is Dynegy's previous announcement that PricewaterhouseCoopers LLP would re-audit Dynegy's 2001 financial statements as part of the previously announced 2001 restatement process. Dynegy later announced that PricewaterhouseCoopers LLP would expand its re-audit to include Dynegy's 1999 and 2000 financial statements. PricewaterhouseCoopers LLP will not re-audit our financial results for these periods except to the extent necessary to support its re-audit of Dynegy's financial statements. We do not expect PricewaterhouseCoopers LLP's re-audit of Dynegy's financial statements to affect our financial statements for 1999 through 2001.

Due to our relationship with Dynegy, adverse developments or announcements concerning Dynegy have affected and could continue to affect our ability to access the capital markets and to otherwise conduct our business. Recent effects include the termination of a July 2002 Mortgage Bond offering and increased collateralization requirements as a result of declining credit ratings. We are particularly susceptible to developments at Dynegy because we rely on an unsecured intercompany note receivable from Illinova Corporation, our direct parent and a Dynegy subsidiary, for a substantial portion of our net cash provided by operating activities. Further, the financial condition of Dynegy could impact the collectibility of the principal balance of the note receivable.

We periodically review the collectibility of the asset represented by the intercompany note receivable from Illinova. As a result of the continuing uncertainty of the financial and liquidity situation of Dynegy and following the recent deterioration in Dynegy's credit ratings, we have reassessed under FAS 114 the realizable value of the intercompany note receivable as of the date of this offering memorandum. Management performed an analysis to measure impairment based on the expected future cash flows discounted at the intercompany note receivable's effective interest rate of 7.5% in accordance with FAS 114. This interest rate does not incorporate the borrower's current credit risk profile and, consequently, the resulting carrying amount of the note receivable will not represent market value. This analysis was based on the probability weighting of multiple cash flow scenarios, including principal and interest payments based on the contractual terms and bankruptcy (both liquidation and reorganization). Under present circumstances, we believe that a non-cash writedown of up to 10% of the \$2.3 billion principal amount of the intercompany note would be appropriate. Measuring any potential impairment requires judgment and estimates and the eventual outcomes may differ from those estimates. Management will continue to assess the factors affecting this analysis through the remainder of the fourth quarter and the amount of the writedown ultimately recorded could be higher or lower than the current estimate based upon changes in Dynegy's circumstances. The final determination regarding the amount and need for a writedown will not be made until our audited financial statements are published for the year ended December 31, 2002. This non-cash adjustment will not have any effect on Illinova's obligations to continue to service the intercompany note in accordance with its terms. We do not believe that the writedown as currently estimated would result in an obligation to make refunds to our retail electric customers under the applicable Illinois return on equity ceiling test or upon our ability to continue to comply with the financial covenants in our \$300 million term loan or the Tilton lease financing. Also, the writedown would not affect the financial statements of our parent company because of the intercompany nature of the obligation. Please read the risk factor titled "Our sources of cash may be insufficient to satisfy our ongoing liquidity requirements" for further discussion.

If Illinova fails to make timely payment to us of interest due on the intercompany note, or, even if Illinova continues to make timely payment to us of such interest, if further declines occur in Dynegy's liquidity position or the market value of its assets relative to its consolidated indebtedness, we could be required to further reduce the carrying value of the intercompany note on our consolidated balance sheet. A larger downward adjustment could, among other things, cause a sufficient increase in our return on equity so as to require customer refunds pursuant to the Customer Choice Law. We currently estimate that a write off of the entire intercompany note receivable would result in an approximate \$14 million refund for 2005 payable in 2006 and an approximate \$35 million refund for 2006 payable in 2007. However, the amount of any required refunds could be materially higher than these estimates based on our actual future operating and financial results, particularly if we were to receive interest payments on the intercompany note subsequent to a write off of the entire intercompany note. A larger adjustment also could result in the acceleration of our obligations under our \$300 million term loan and our Tilton lease financing and limit our ability to incur additional indebtedness in the future.

Dynegy stated in its third quarter 2002 Form 10-Q that if it is unable to execute the remaining elements of its strategy, it may be forced to consider other strategic alternatives including a possible reorganization under the protection of federal bankruptcy laws. Please read Dynegy's Form 10-Q for the quarter ended September 30, 2002 for additional discussion of the issues affecting and that could affect Dynegy and its subsidiaries, including us. Please also read the risk factor titled "A bankruptcy filing by Dynegy could lead to our own bankruptcy filing and would materially adversely affect our ability to make payments on the Offered Bonds" for further discussion.

Sale of Transmission Assets

On October 9, 2002, we announced that we had agreed to sell our electric transmission assets to Trans-Elect, an independent transmission company, for \$239 million before income tax and other deductions. The net proceeds of this sale after income taxes and other transaction expenses are expected to be approximately \$180 million. The net book value of these assets is estimated to be approximately \$143 million at September 30, 2002. Facilities to be included are expected to be 1,687 circuit miles of 345,000-volt and 138,000-volt transmission lines, 20 transmission substations and the transmission assets within an additional 40 substations. We will retain our 37,708 circuit miles of overhead and underground lines and associated substations that comprise our electric distribution system throughout Central and Southern Illinois.

The transaction is expected to close in the first half of 2003, subject to required approvals from the SEC, the Federal Trade Commission, the ICC and the FERC, as well as other closing conditions. With respect to the FERC, the sale is conditioned on its approving the levelized rates application to be filed by Trans-Elect seeking a 13% return on equity (based on a capital structure of equal portions of debt and equity), which results in a significant increase in transmission rates over the rates we currently charge. If the FERC does not approve levelized rates in substantially the form and amount sought by Trans-Elect, then Trans-Elect will not be obligated to close on the sale pursuant to the parties' signed asset purchase agreement. As a result of our credit ratings, the asset purchase agreement requires us to post a \$10 million letter of credit at closing in support of our obligations under the agreement.

The purchase price is subject to adjustment with respect to certain items, including final agreement as to the precise transmission assets to be sold, any variance in the assumed amount of inventory on hand and the amount of accounts payable at closing. A change in interest rates from those estimated by Trans-Elect in contemplating its financing for the sale also could cause an adjustment to the purchase price or postponement of the closing, at our option. These interest rates are dependent in part on our credit ratings because we will initially provide approximately 60% of Trans-Elect's revenues. In addition, if Trans-Elect is unable to complete the financing of the sale in whole or in part because of an adverse credit event affecting our ability to perform our obligations under the asset purchase agreement, Trans-Elect may terminate the agreement. There can be no assurance that the proposed sale of our electric transmission assets to Trans-Elect will be consummated.

The pre-tax gain on the sale is estimated to be approximately \$90 million and will be recorded upon the closing of the transaction. In addition, as a result of the sale, we expect to accelerate approximately \$90 million of regulatory asset amortization. The sale, if approved, is expected to reduce our annual operating income by approximately \$15.4 million and our annual EBITDA by approximately \$46.0 million. However, after giving effect to the expected reduction in capital expenditures otherwise required for the operation of these assets, we believe that the net cash flow effect of the sale on us will be minimal.

Upon transfer of ownership of these transmission facilities, we will contract for use of such facilities on the same basis as other transmission customers. Trans-Elect will participate in a FERC-approved RTO under the same conditions that would have applied to us. On December 16, 2002, Trans-Elect announced that it intends to file with the FERC for approval to join the MISO. If the FERC approves of Trans-Elect's joining the MISO, we would be required to post a letter of credit of up to approximately \$37 million at closing, depending on our credit ratings, to support our transmission payment obligations. In addition, we expect to file to join the MISO in the near future. Agreements between us and Trans-Elect will provide continued interconnection of the existing distribution and transmission systems and for joint use of shared facilities, such as existing substations and poles

that support both transmission and distribution equipment. In addition, we will provide services to operate and maintain the transmission system sold to Trans-Elect for an initial period of five years.

Factors Affecting Future Operating Results

Our financial condition and results of operations in the fourth quarter of 2002 and beyond may be significantly affected by a number of factors, including:

- our ability to successfully consummate the Trans-Elect transaction;
- our ability to execute our business strategy of delivering reliable transmission and distribution services in a cost-effective manner;
- our ability to address our significant leverage given our non-investment grade status, lack of borrowing capacity and relationship with Dynegy;
- the effects of past or future regulatory actions, including Illinois power market deregulation and, specifically, "direct access" on our electric business;
- our ability to receive payments under our intercompany note receivable and to otherwise receive continued performance under our arrangements with Dynegy;
- our ability to maintain or improve our credit ratings;
- the effects of weather on our electric and gas business; and
- our ability to secure power and natural gas for our electric and gas customers.

Please read "Forward-Looking Statements" above for additional factors that could impact future operating results.

Regulatory Matters

Fossil Generation Transfer

In August 1999, the FERC, under Part 205 of the Federal Power Act, approved our filing to put into place a power purchase agreement between our company and Illinova Power Marketing Inc. In September 1999, the FERC, under Part 203 of the Federal Power Act, approved our filing to transfer our wholly owned fossil generating assets to our parent, Illinova, and subsequently its affiliate, Illinova Power Marketing. These approvals, along with the previously received approval from the ICC, satisfied all regulatory requirements related to the formation of Illinova Power Marketing and the transfer to Illinova Power Marketing of our non-nuclear generating assets.

In October 1999, our wholly owned fossil generating assets and other generation-related assets and liabilities were transferred at book value to Illinova in exchange for an unsecured note in the amount of \$2.8 billion. Illinova then contributed these assets to DMG (formerly Illinova Power Marketing). During 2001, approximately \$9.3 million of additional fossil generation-related assets were transferred and the unsecured note receivable was adjusted accordingly. The note between our company and Illinova matures September 30, 2009 and bears interest at an annual rate of 7.5%, payable semiannually on the first day of April and October each year. At September 30, 2002, principal outstanding under this note receivable was approximately \$2.3 billion with no accrued interest. Please read the risk factor titled "We are particularly susceptible to developments at Dynegy because we rely on an unsecured note receivable from Illinova for a substantial portion of our net cash provided by operating activities" for further discussion.

We negotiated a power purchase agreement with DMG to provide us with continued energy supply from the transferred fossil generating assets. The power purchase agreement became effective on October 1, 1999 and

has a primary term that continues through December 31, 2004, with provisions to extend the agreement thereafter on an annual basis, subject to concurrence by both parties and regulatory approval. The power purchase agreement defines the terms and conditions under which DMG provides capacity and energy to us using a tiered pricing structure. An amendment to the power purchase agreement was filed by DMG on October 16, 2000, and received the FERC's approval on November 16, 2000. The amendment adjusts the prices and quantities for energy and capacity to be provided under the power purchase agreement by DMG to us, effective January 1, 2001 through the end of 2004.

The power purchase agreement specifies that we are responsible for dispatching DMG's generating units recognizing specified design limits on unit operation. We will generally follow the principles of economic dispatch, while fulfilling our obligation to maintain adequate reliability of our transmission system. If we dispatch the generating units out of economic order for reliability purposes, we compensate DMG for the associated cost. We provide load schedules to DMG and may be required to compensate DMG for overscheduling. DMG is required to provide planned outage schedules for the generating units to us and must consider our reliability needs in developing the schedules.

DMG is responsible for adequately maintaining its generating capacity, obtaining necessary licenses and permits, maintaining minimum levels of insurance coverage, procuring fuel and reporting certain performance data. The power purchase agreement also specifies metering, billing, dispute resolution procedures and defines force majeure conditions.

Please read the risk factor titled "We depend upon long-term arrangements with third parties, including Dynegy, for substantially all of the power we purchase for resale to our customers" for further discussion of the power purchase agreement with DMG.

For a discussion of additional regulatory matters affecting our company, please read "Business—Open Access and Competition."

Power Supply and Reliability

During 2000 and 2001, We secured our power requirements through power purchase contracts. For further discussion, please read "Note 3—Clinton Impairment, Quasi-Reorganization and Sale of Clinton" and "Note 4—Related Parties" to the audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2001.

Other Matters

Competition

Competition has become a dominant issue for the electric utility industry. It is a significant departure from traditional regulation in which public utilities have a universal obligation to serve the public in return for protected service territories and regulated pricing designed to allow a reasonable return on prudent investments and recovery of operating costs. The enactment of the Energy Policy Act of 1992 authorized the FERC to mandate wholesale wheeling of electricity by utilities at the request of certain authorized generating entities and electric service providers. Wheeling is the transport of electricity generated by one entity over transmission and distribution lines belonging to another entity. Retail wheeling involves the transport of electricity to end-use customers. The Energy Policy Act currently precludes the FERC from mandating retail wheeling.

Competition also arises from municipalities seeking to extend their service boundaries to include customers being served by utilities. The right of municipalities to have power wheeled to them by utilities was established in 1973. We have been obligated to wheel power for municipalities and cooperatives in our territory since 1976.

Further competition may be introduced by state action, as has occurred in Illinois, or by federal regulatory action. P.A. 90-561, Illinois electric utility restructuring legislation, was enacted in December 1997 and amended in 2002.

Seasonality

Our revenue and operating margin are impacted by seasonal factors that affect sales volumes of electricity and gas. Typically, revenues from sales of electricity are higher in the summer months resulting from the summer cooling season; whereas, gas revenues are higher in the winter months resulting from the winter heating season.

Effect of Inflation

Although our operations are affected by general economic trends, we do not believe inflation has had a material effect on our results of operations.

Manufactured Gas-Plants

Please read "Note 5—Commitments and Contingencies" to the audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2001 for a discussion of our manufactured gas plant liabilities.

Environmental Matters

Please read "Note 5—Commitments and Contingencies" to the audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2001 and to the unaudited financial statements included in our quarterly report on Form 10-Q for the quarter ended September 30, 2002 and "Business—Environmental Matters" for a discussion of environmental matters that impact or could potentially impact us.

Tax Matters

Please read "Note 8—Income Taxes" to the audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2001 for a discussion of effective tax rates and other tax issues.

Business Risk-Management Assessment

Our operating results may be impacted by commodity price fluctuations for electricity used in supplying service to our customers. We have contracted with AmerGen and DMG to supply power via power purchase agreements that expire at the end of 2004. Should power acquired under these agreements be insufficient to meet our load requirements, we will have to buy power from third parties at current market prices. The power purchase agreements with DMG obligates DMG to provide power up to the reservation amount, and at the same prices, even if DMG has individual units unavailable at various times. The power purchase agreement with AmerGen does not obligate AmerGen to acquire replacement power for us in the event of a curtailment or shutdown at Clinton. Under a Clinton shutdown scenario, to the extent we exceed our capacity reservation with DMG, we will have to buy power at current market prices. Such purchases would expose us to commodity price risk. As discussed above, P.A. 90-561 was amended to extend the retail electric rate freeze for two additional years, through 2006. We have begun discussions to establish power purchase agreements to cover this period, including the possible modification or extension of our existing power purchase agreements.

The ICC determines our delivery rates for gas service. These rates have been designed to recover the cost of service and allow shareholders the opportunity to earn a reasonable rate of return. The gas commodity is a pass through cost to the end-use customer and is subject to an annual ICC prudence review. Future natural gas

sales will continue to be affected by an increasingly competitive marketplace, changes in the regulatory environment, transmission access, weather conditions, gas cost recoveries, customer conservation efforts and the overall economy. Price risk associated with our gas operations is mitigated through contractual terms applicable to the business, as allowed by the ICC. We apply prudent risk-management practices in order to minimize these market risks. Such risk management practices may not fully mitigate these exposures.

- Prior to the Dynegy-Illinova merger in February 2000, we periodically utilized interest rate derivatives (principally interest rate swaps and caps) to adjust the portion of our overall borrowings subject to interest rate risk. As of September 30, 2002 and December 31, 2001, there were no interest rate derivatives outstanding.

Our market risk is considered as a component of the entity-wide risk-management policies of our indirect parent company, Dynegy. Dynegy measures entity-wide market risk in its financial trading and risk-management portfolios using Value at Risk. Additional measures are used to determine the treatment of risks outside the Value at Risk methodologies, such as market volatility, liquidity, event and correlation risk.

Certain Critical Accounting Policies

We periodically review the collectibility of the asset represented by the intercompany note receivable from Illinova. As a result of the continuing uncertainty of the financial and liquidity situation of Dynegy and following the recent deterioration in Dynegy's credit ratings, we have reassessed under FAS 114 the realizable value of the intercompany note receivable as of the date of this offering memorandum. Management performed an analysis to measure impairment based on the expected future cash flows discounted at the intercompany note receivable's effective interest rate of 7.5% in accordance with FAS 114. This interest rate does not incorporate the borrower's current credit risk profile and, consequently, the resulting carrying amount of the note receivable will not represent market value. This analysis was based on the probability weighting of multiple cash flow scenarios, including principal and interest payments based on the contractual terms and bankruptcy (both liquidation and reorganization). Under present circumstances, we believe that a non-cash writedown of up to 10% of the \$2.3 billion principal amount of the intercompany note would be appropriate. Measuring any potential impairment requires judgment and estimates and the eventual outcomes may differ from those estimates. Management will continue to assess the factors affecting this analysis through the remainder of the fourth quarter and the amount of the writedown ultimately recorded could be higher or lower than the current estimate based upon changes in Dynegy's circumstances. The final determination regarding the amount and need for a writedown will not be made until our audited financial statements are published for the year ended December 31, 2002. This non-cash adjustment will not have any effect on Illinova's obligations to continue to service the intercompany note in accordance with its terms. We do not believe that the writedown as currently estimated would result in an obligation to make refunds to our retail electric customers under the applicable Illinois return on equity ceiling test or upon our ability to continue to comply with the financial covenants in our \$300 million term loan or the Tilton lease financing. Also, the writedown would not affect the financial statements of our parent company because of the intercompany nature of the obligation. Please read the risk factor titled "Our sources of cash may be insufficient to satisfy our ongoing liquidity requirements" for further discussion.

For a discussion of our other critical accounting policies, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations—Accounting Matters" in our annual report on Form 10-K for the year ended December 31, 2001.

BUSINESS

General

We were incorporated under the laws of the State of Illinois on May 25, 1923 and are headquartered in Decatur, Illinois. We have publicly traded shares of preferred stock outstanding, but all of the issued and outstanding shares of our common stock are owned by Illinova Corporation. On February 1, 2000, Illinova and its subsidiaries, including us, were acquired by Dynegy Inc. The transaction involved the creation of a new holding company, now known as Dynegy Inc., and two separate but concurrent mergers. As a result of these two mergers, in which wholly owned subsidiaries of Dynegy Inc. merged with and into the former Dynegy and Illinova, respectively, Illinova and the former Dynegy continue to exist as wholly owned subsidiaries of Dynegy Inc. Dynegy is headquartered in Houston, Texas.

We are engaged in the transmission, distribution and sale of electric energy and the distribution, transportation and sale of natural gas in the State of Illinois. We are affected by changes in the electric utility industry driven by regulatory and legislative initiatives to introduce competition and end monopoly franchises. One of these changes, "direct access," provides customers the freedom to purchase electricity from alternate suppliers. In December 1997, electric regulatory restructuring legislation providing for "direct access," among other things, was enacted by the Illinois General Assembly. For a more detailed discussion of these developments, please read "— Open Access and Competition" below.

Customer Data

The territory we serve comprises substantial areas in Northern, Central and Southern Illinois, including 11 cities with populations greater than 30,000 and 27 cities with populations greater than 10,000 (2000 U.S. Census Bureau's Redistricting Data). We supply electric service at retail to an estimated aggregate population of 1,372,000 in 311 incorporated municipalities, adjacent suburban and rural areas, and numerous unincorporated communities and retail natural gas service to an estimated population of 1,019,000 in 266 incorporated municipalities and adjacent areas. We hold franchises in all of the 311 incorporated municipalities in which we furnish retail electric service and in all of the 266 incorporated municipalities in which we furnish retail gas service. At January 3, 2002, we served 588,765 active electric customers (billable meters) and 412,142 active gas customers (billable meters). These numbers do not include customers served by non-metered equipment, such as street lights. Sales of electricity and gas and transportation are affected by seasonal weather patterns; therefore, operating revenues and associated operating expenses are not distributed evenly during the year. No customer accounted for 10% or more of our consolidated revenues in 2001.

Electric Business

Overview

We supply electric service at retail to residential, commercial and industrial consumers in substantial portions of northern, central and southern Illinois. Electric transmission service is also supplied to numerous utilities, municipalities and power marketing entities.

Our highest system peak hourly demand (native retail load) in 2001 was 3,475,000 kW on July 23, 2001. This compares with our record high system peak hourly demand (native retail load) of 3,888,000 kW on July 29, 1999.

We are a participant, together with Ameren—Union Electric Company, referred to as "AmerenUE," and Ameren—Central Illinois Public Service Company, referred to as "AmerenCIPS," in the Illinois-Missouri Power Pool, which was formed in 1952. The Illinois-Missouri Power Pool operates under an interconnection agreement that provides for the interconnection of transmission lines. This agreement has no expiration date, but any party may withdraw from the agreement on 36 months' written notice. We, AmerenCIPS and AmerenUE have

contracted with the Tennessee Valley Authority for the interconnection of its system with those of our three companies. The contract addresses power purchase provisions among the parties and other working arrangements. This contract has no expiration date, but any party may withdraw from the agreement on five years' written notice.

We also have interconnections with Indiana-Michigan Power Company, Commonwealth Edison Company, Central Illinois Light Company, MidAmerican Energy Corporation, Louisville Gas & Electric, Southern Illinois Power Cooperative, Electric Energy Inc. and the City of Springfield, Illinois.

We are a member of the Mid-America Interconnected Network, one of ten regional reliability councils established to coordinate plans and operations of member companies regionally and nationally.

Fossil Generation

On August 24, 1999, the FERC, under Part 205 of the Federal Power Act, approved our filing to put into place a power purchase agreement between Illinois Power and Illinova Power Marketing Inc. Also, on September 10, 1999, the FERC, under Part 203 of the Federal Power Act, approved our filing to transfer all of our wholly owned fossil generating assets to Illinova. These approvals, along with the previously received approval from the ICC, satisfied all regulatory requirements related to the formation of Illinova Power Marketing and the transfer to Illinova Power Marketing of our wholly owned fossil generating assets. On October 1, 1999, we transferred all of our wholly owned fossil generating assets to Illinova, at book value, in exchange for a note receivable. Illinova subsequently contributed these assets and certain liabilities to Illinova Power Marketing, which was later renamed Dynegy Midwest Generation. The power purchase agreement became effective on October 1, 1999 and has a primary term that continues through December 31, 2004, with provisions to extend the agreement thereafter on an annual basis, subject to concurrence by both parties. The power purchase agreement defines the terms and conditions under which DMG provides capacity and energy to us using a tiered pricing structure. An amendment to the power purchase agreement was filed by DMG on October 16, 2000 and received the FERC's approval on November 16, 2000. The amendment adjusts the prices and quantities for energy and capacity to be provided under the power purchase agreement by DMG to us, effective January 1, 2001 through the end of 2004.

Nuclear Generation

On April 15, 1999, we announced that we had reached an interim agreement with AmerGen whereby AmerGen would purchase and operate Clinton and we would buy at least 80% of the plant's electricity output in 1999 and at least 75% during the years 2000 through 2004.

On December 15, 1999, we completed the sale of Clinton to AmerGen. Basic terms for the sale were unchanged from a definitive agreement announced on July 1, 1999. AmerGen paid Illinois Power \$12.4 million for the plant and property and assumed responsibility for operating and ultimately decommissioning Clinton.

We agreed to transfer to AmerGen the existing decommissioning trust funds in the amount of \$98.5 million on the sale closing date and to make an additional payment of \$113.4 million to the decommissioning trust funds. In addition, we agreed to make five annual payments of approximately \$5.0 million through 2004 to the decommissioning trust funds, of which two payments have been made through December 2001. For more information on Nuclear Generation, please read "Note 3—Clinton Impairment, Quasi-Reorganization and Sale of Clinton" to the audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2001.

Power Supply

Our transfer of our wholly owned fossil generating assets to Illinova and the December 1999 sale of Clinton to AmerGen changed the method by which we obtain our electricity to supply our retail customers. In

conjunction with the aforementioned events, we entered into power purchase agreements with Illinova Power Marketing, which was later renamed Dynegy Midwest Generation, and AmerGen in order to meet our service obligations under the Illinois Public Utilities Act. These agreements secure our energy requirements at pre-determined rates. The AmerGen power purchase agreement was entered into pursuant to the terms of the Clinton asset sale agreement, which obligates us to purchase at least 75% of Clinton's electricity output through 2004 at fixed prices that exceed current and projected wholesale prices. The DMG power purchase agreement obligates DMG to provide capacity and energy to us through at least December 31, 2004 using a tiered pricing structure.

We believe we have provided for adequate power supply for our expected load plus a reserve supply above that expected level. Should power acquired under these agreements be insufficient to meet our load requirements, we will have to buy power from third parties at current market prices. The power purchase agreement with DMG obligates DMG to provide power up to the reservation amount even if DMG has individual units unavailable at various times. The power purchase agreement with AmerGen does not obligate AmerGen to acquire replacement power for us in the event of a curtailment or shutdown at Clinton. Under a Clinton outage scenario, to the extent we exceed our capacity reservation with DMG, we will have to buy power at current market prices. Volatility of the power market could affect the prices at which we would purchase any such necessary power. For more information on Clinton and the AmerGen power purchase agreement, please read "Note 3—Clinton Impairment, Quasi-Reorganization and Sale of Clinton" to the audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2001. For more information on the DMG power purchase agreement, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations—Regulatory Matters" above and "Note 4—Related Parties" to the audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2001.

Construction Program

To meet anticipated construction needs, we have used internally generated funds and external financings. The timing and amount of external financings depend primarily on economic and financial market conditions, cash needs and capitalization ratio objectives. For more information on our liquidity, please read "Note 6—Revolving Credit Facilities, Letters of Credit and Short-Term Loans" to the audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2001 and "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources" above.

Gas Business

Overview

We supply retail natural gas service to residential, commercial and industrial consumers in substantial portions of northern, central and southern Illinois. We do not sell gas for resale.

Our rate schedules contain provisions for passing through to our gas customers increases or decreases in the cost of purchased gas. For information on revenue and energy costs, please read the sub-caption "Revenue Recognition and Energy Cost" of "Note 1—Summary of Significant Accounting Policies" to the audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2001.

We have seven underground gas storage fields having a capacity at December 31, 2001 of approximately 11.6 Billion Cubic Feet, or BCF, and a total deliverability on a peak day of about 289,000 Thousand Cubic Feet, or MCF. In addition to the capacity of the seven underground storage fields, we had contracts with natural gas pipelines at December 31, 2001 for 5.1 BCF of underground storage capacity and a total deliverability on a peak day of 93,000 MCF. Operation of underground storage permits us to increase deliverability to our customers during peak load periods by taking gas into storage during the off-peak months.

We experienced our 2001 peak-day send out of 566,461 million British thermal units, referred to as "MMBtu," of natural gas on January 2, 2001. This compares with our record peak-day send out of 857,324 MMBtu of natural gas on January 10, 1982.

Gas Supply and Transportation

We have contracts on six interstate pipelines for firm transportation and storage services. These contracts have varying expiration dates ranging from 2002 to 2012. We also enter into contracts for the acquisition of natural gas supply ranging in duration from one to five months.

Environmental Matters

We are subject to regulation by certain federal and Illinois authorities with respect to environmental matters and may in the future become subject to additional regulation by such authorities or by other federal, state and local governmental bodies. We do not expect that our compliance with any such environmental regulations will have a material adverse effect upon our capital expenditures, earnings or competitive position. Please also read "Legal Proceedings—U.S. Environmental Protection Agency Complaint" set forth in our annual report on Form 10-K for the year ended December 31, 2001.

Manufactured Gas Plant Sites

We previously operated two dozen sites at which synthetic gas was manufactured from coal. Operation of these manufactured gas plant sites was generally discontinued in the 1950s when natural gas became available from interstate gas transmission pipelines. Many of these manufactured gas plant sites were contaminated with residues from the gas manufacturing process. Although we estimate our liability for manufactured gas plant site remediation to be approximately \$53 million for our remaining 22 manufactured gas plant sites, because of the unknown and unique characteristics at each site, we cannot currently determine our ultimate liability for remediation of the sites. In October 1995, we initiated litigation against a number of our insurance carriers. Settlement proceeds recovered from these carriers offset a portion of the estimated manufactured gas plant remediation costs and are credited to customers through the tariff rider mechanism that the ICC previously approved. Cleanup costs in excess of insurance proceeds are considered probable of recovery from our electric and gas customers.

Electric and Magnetic Fields

The possibility that exposure to electric and magnetic fields, referred to as "EMFs," emanating from power lines, household appliances and other electric sources may result in adverse health effects continues to be the subject of governmental, medical and media attention. Two major scientific studies concluded in 1999 failed to demonstrate significant EMF health risk; however, a definitive conclusion may never be reached on this topic, and future impacts are unpredictable. Therefore, we continue to compile the latest research information on this topic. At the same time, we conduct EMF monitoring in the field when customers express a concern. Written materials explaining the perceived hazards are also available to the public.

Other Issues

Hazardous and non-hazardous wastes generated by us must be managed in accordance with federal regulations under the Toxic Substances Control Act, referred to as the "TSCA," the Comprehensive Environmental Response, Compensation and Liability Act and the Resource Conservation and Recovery Act, referred to as the "RCRA," and additional state regulations promulgated under both RCRA and state law. Regulations promulgated in 1988 under RCRA govern our use of underground storage tanks. The use, storage and disposal of certain toxic substances, such as polychlorinated biphenyls in electrical equipment, are regulated under the TSCA. Hazardous substances used by us are subject to reporting requirements under the Emergency Planning and Community-Right-To-Know Act. The State of Illinois has been delegated authority for

enforcement of these regulations under the Illinois Environmental Protection Act and state statutes. These requirements impose certain monitoring, record keeping, reporting and operational requirements that we have implemented or are implementing to assure compliance. We do not anticipate that compliance will have a material adverse impact on our financial position or results of operations.

Research and Development

Research and development expenditures were approximately \$1 million for each of 2001 and 2000, down considerably from the \$4.4 million spent in 1999. Expenditures in 1999 were primarily focused on the wholly owned generating assets. Our wholly owned generating assets were transferred or sold in 1999; consequently, research and development expenditures decreased accordingly.

Open Access and Competition

Competition has become a dominant issue for the electric utility industry. It is a significant departure from traditional regulation in which public utilities have a universal obligation to serve the public in return for protected service territories and regulated pricing designed to allow a reasonable return on prudent investment and recovery of operating costs. The enactment of the Energy Policy Act of 1992 authorized the FERC to mandate wholesale wheeling of electricity by utilities at the request of certain authorized generating entities and electric service providers. Wheeling is the transport of electricity generated by one entity over transmission and distribution lines belonging to another entity. Retail wheeling involves the transport of electricity to end-use customers. The Energy Policy Act currently precludes the FERC from mandating retail wheeling.

Competition arises from municipalities seeking to extend their service boundaries to include customers being served by utilities. The right of municipalities to have power wheeled to them by utilities was established in 1973. We have been obligated to wheel power for municipalities and cooperatives in our territory since 1976.

Further competition may be introduced by state action, as has occurred in Illinois, or by federal regulatory action. P.A. 90-561, Illinois electric utility restructuring legislation, was enacted in December 1997. Some of the major effects of this and subsequent legislation are noted in the following paragraphs.

P.A. 90-561 – Rate Adjustment Provisions P.A. 90-561 gave our residential customers a 15% decrease in base electric rates beginning August 1, 1998. An additional 5% decrease went into effect on May 1, 2002 and is to remain effective through December 31, 2006, due to recently passed legislation. The combined impact of these rate decreases is expected to result in a total annual revenue reduction of approximately \$91 million in 2002, \$101 million in 2003, \$103 million in 2004, \$105 million in 2005 and \$107 million in 2006, relative to rate levels in effect prior to August 1, 1998. Please read the risk factor titled "Our business is subject to extensive regulation, the effects of which could negatively impact our ability to satisfy our obligations, including the Offered Bonds" for further discussion of recent developments with respect to residential rates in Illinois.

P.A. 92-0537 – Extension of Retail Electric Rate Freeze On June 6, 2002, the Governor of Illinois signed a bill that adds two years to the current retail electric rate freeze in Illinois. The bill extends through 2006 the mandatory retail electric rate freeze, which was originally required by P.A. 90-561. P.A. 92-0537 freezes our rates for full service, or "bundled" electric service at current levels unless the two-year average of our earned return on equity is below the two-year average of the monthly average yields of 30-year U.S. Treasury Bonds through January 2002, an average of the 30-year U.S. Treasury Bonds and Monthly Treasury Long-Term Average Rates in February 2002, and the Monthly Treasury Long-Term Average Rates (25 years and above) after February 2002 for the concurrent period, in which event we may request a rate increase from the ICC. The ICC would rule on this request for a rate increase using traditional ratemaking standards. As a result of the retail rate freeze, our bundled service retail electricity consumers are expected to continue to pay their current electric rates through 2006. The rate freeze does not apply to our rates for distribution service to customers choosing

direct access. These rates are currently required to be based on cost of service and can be raised or lowered by the ICC as the result of a rate proceeding. Beginning in 2007, absent further extension of the retail electric rate freeze or other action, we expect that the distribution and transmission component of retail electric rates will continue to be required to be based on costs while the power and energy component may be required to be based on prices in the wholesale market. For a further discussion, please read the risk factor titled "Our business is subject to extensive regulation, the effects of which could negatively impact our ability to satisfy our obligations, including the Offered Bonds."

P.A. 90-561/92-0537—Utility Earnings Cap The regulatory reform legislation contains floor and ceiling provisions applicable to our return on equity during the mandatory transition period ending in 2006. Pursuant to the provisions in the legislation, we may request an increase in our base rates if the two-year average of our earned return on equity is below the two-year average of the monthly average yields of the 30-year U.S. Treasury Bonds through January 2002, an average of the 30-year U.S. Treasury Bonds and Monthly Treasury Long-Term Average Rates in February 2002, and the Monthly Treasury Long-Term Average Rates (25 years and above) after February 2002 for the concurrent period ("Treasury Yield"). Conversely, we are required to refund amounts to our customers equal to 50% of the value earned above a defined "ceiling limit." The ceiling limit is exceeded if our two-year average return on equity exceeds the Treasury Yield, plus 6.5% in 2002 through 2006 (which increases to 8.5% in 2002 through 2006 if we choose not to request transition charges after 2006). Regulatory asset amortization is included in the calculation of return on equity for the ceiling test but is not included in the calculation of return on equity for the floor test. Prior to February 2002, the return on equity test was based on the two-year average of the monthly average yields of 30-year U.S. Treasury Bonds. During 2001, our two-year average return on equity was within the allowable return on equity collar and is expected to be within the return on equity collar in 2002.

P.A. 90-561 – Direct Access Provisions Since October 1999, non-residential customers with demand greater than 4 megawatts at a single site, customers with at least 10 sites having aggregate total demand of at least 9.5 megawatts and customers representing one-third of the remaining load in the non-residential class have been given the right to choose their electric generation suppliers, referred to as "direct access." Direct access for remaining non-residential customers began on December 31, 2000. Direct access became available to all residential customers in May 2002. However, at the present there are no alternative residential electric suppliers registered to provide service to our residential customers. We remain obligated to provide both bundled electricity service and delivery service to our customers at regulated rates. Customers taking delivery service, rather than bundled service, must pay transition charges to us, but those charges are not designed to compensate us for all of our lost revenues resulting from customers switching from bundled service to delivery service.

Although residential rate reductions and the introduction of direct access have led to lower electric service revenues, P.A. 90-561 is designed to protect the financial integrity of electric utilities in three principal ways:

- Customers choosing direct access are obligated to pay transition charges based on the utility's lost revenue from that customer. The transition charges are applicable through 2006 and can be extended up to two additional years with approval by the ICC. However, we do not expect to request such an extension.
- Utilities are provided the opportunity to lower their financing and capital costs through the issuance of "securitized" bonds, also called transitional funding notes.
- The return on equity of utilities is managed through application of floor and ceiling test rules contained in P.A. 90-561/92-0537 as described above.

The extent to which revenues are affected by P.A. 90-561 will depend on a number of factors, including future market prices for wholesale and retail energy, load growth and demand levels in our current service territory, and the extent to which customers elect direct access.

P.A. 90-561 – Independent System Operator Participation Participation in an Independent System Operator, referred to as an "ISO," by utilities serving retail customers in Illinois was one of the requirements included in P.A. 90-561. Effective on July 1, 2001, the ISO requirements of P.A. 90-561 were amended by P.A. 92-12 to provide that a regional transmission organization, referred to as a "RTO," created under FERC rules shall be considered to be the functional equivalent of an ISO. An electric utility shall be deemed to meet its obligation to participate in an ISO through membership in a RTO that fulfills the requirements of an ISO as set forth in P.A. 90-561.

In January 1998, we, in conjunction with eight other transmission-owning entities, filed with the FERC for all approvals necessary to create and to implement the Midwest Independent Transmission System Operator, referred to as the "MISO." On October 13, 2000, we filed a notice of our intent to withdraw from the MISO with the FERC. On February 23, 2001, we reached a settlement in principle with all parties that allowed us to withdraw from the MISO and join the Alliance RTO, effective upon the FERC's approval of the settlement, which occurred May 8, 2001. We have fulfilled our obligations under the MISO settlement.

On August 21, 2001, we and seven of the transmission owners proposing to form the Alliance RTO entered into a letter of intent with National Grid, USA pursuant to which National Grid would serve as the Alliance RTO's managing member for a period of seven years. On November 1, 2001, the Alliance companies filed the definitive agreements with the FERC for approval.

In an order issued on December 20, 2001, the FERC reversed its previous findings and stated that it could not approve the Alliance RTO as a RTO. The FERC further directed the Alliance companies to explore how their business plan, including the participation of National Grid, could be accommodated within the MISO. In addition, the FERC directed the Alliance companies to file a statement of their plans to join a RTO, including the timeframe, within 60 days of December 20th.

On January 8, 2002, the Alliance companies and National Grid commenced substantive discussions with the MISO as directed by the FERC. In addition, the Alliance companies continued to consider other opportunities for participation in an RTO. On February 19, 2002, we, in conjunction with the Alliance companies, filed a report with the FERC stating that the Alliance companies have been in discussions with both MISO and PJM Interconnection LLC, referred to as "PJM," but have been unable to reach agreement. On March 5, 2002, we, in conjunction with the Alliance companies, filed a second report and petition for declaratory order with the FERC. The petition requests approval of a structure under which National Grid would operate a for-profit transmission company consisting of the Alliance companies' transmission assets under the oversight of the MISO. On April 25, 2002, the FERC issued an order granting in part the Alliance companies' petition. The order stated the position of the FERC with regard to the split of functions between the MISO, as the RTO for the region, and Alliance GridCo, as a for-profit independent transmission company that operates under the MISO. The FERC also approved the rate design proposed by the Alliance companies, whether they join PJM, MISO or another RTO. The FERC clarified that if the Alliance companies join MISO, the MISO must return the \$60 million paid by the Illinois utilities to exit the MISO. Finally, the FERC directed the Alliance companies to submit a compliance filing within 30 days indicating which RTO they will join, and whether their participation will be collective or individual.

On May 28, 2002, we submitted a letter to the FERC indicating that we would join PJM either as an individual transmission owner or as part of an independent transmission company. On June 21, 2002, PJM, National Grid, American Electric Power Service Corporation, referred to as "AEP," Commonwealth Edison Company, referred to as "ComEd," and we entered into a memorandum of understanding outlining a 30-day process under which AEP, ComEd and we, referred to as the "ITC Participants," would pursue the formation of an independent transmission company under PJM with National Grid serving as the independent manager or administrator of the independent transmission company. The memorandum of understanding was filed with the FERC on June 25, 2002. An ITC Participant or National Grid will be excused from its obligations under the memorandum of understanding if any of such parties are unable to reach the agreements necessary to participate

in PJM through the independent transmission company. If an ITC Participant is unable to reach such agreements, each party is committed to join PJM as an individual transmission owner.

On July 31, 2002, FERC issued an order approving our proposal to join PJM, subject to certain conditions. These conditions include a requirement that (i) the parties negotiate and implement a rate design that will eliminate rate pancaking between PJM and MISO, and (ii) the North American Electric Reliability Council oversee the reliability plans for MISO and PJM. In addition, FERC has initiated an investigation under Federal Power Act section 206 of MISO, PJM West and PJM's transmission rates for through and out service and revenue distribution. If we successfully complete the sale of our transmission system assets to Trans-Elect, it is expected that Trans-Elect, rather than us, will join the RTO. Please read "Offering Memorandum Summary—Recent Developments" for a further discussion of the pending sale of our transmission system assets to Trans-Elect.

Subsequent to the above actions, we terminated our discussions with PJM and expect to file to request FERC approval to join the MISO. This expected filing relates to our joint filing with Trans-Elect on December 16, 2002 seeking FERC approval for the proposed transfer of our transmission assets to Trans-Elect. In this application, Trans-Elect stated its intention to join the MISO effective as of the closing of the sale of our electric transmission assets. Trans-Elect's application to purchase our transmission assets is contingent upon approval of the rate proposal as described above, which was filed contemporaneously with the transfer application. We cannot predict the outcome of these proceedings at this time.

Regulation

We are an electric utility as defined in the Public Utility Holding Company Act of 1935, referred to as "PUHCA." Our direct parent company, Illinova, and Dynegy are holding companies as defined in PUHCA. However, both Illinova and Dynegy generally are exempt from regulation under section 3(a)(1) of PUHCA. They remain subject to regulation under PUHCA with respect to the acquisition of certain voting securities of other domestic public utility companies and utility holding companies.

In recent years, several bills have been introduced in Congress that would repeal PUHCA. Repeal or significant modification to PUHCA could affect us and the electric utility industry generally. We cannot predict the outcome of the repeal efforts.

The Illinois Public Utilities Act was significantly modified in 1997 by P.A. 90-561, but the ICC continues to have broad powers of supervision and regulation with respect to our rates and charges, our services and facilities, extensions or abandonment of service, classification of accounts, valuation and depreciation of property, issuance of securities and various other matters. We must continue to provide bundled retail electric service to all who choose to continue to take service at tariff rates, and we must provide unbundled electric distribution services to all eligible customers as defined by P.A. 90-561 at rates to be determined by the ICC. During 2001, the ICC ruled on (i) the establishment of a market value index (in lieu of a neutral fact finder price) used in (a) calculating competitive transition costs and (b) our power purchase tariff; and (ii) transactions between the gas utility and its affiliates. During 2002, the ICC has ruled on guidelines regarding standards of conduct and functional separation for electric utilities and our residential electric delivery service tariffs. The impact of these regulations on our financial condition and results of operations cannot be predicted with certainty.

We are subject to regulation under the Federal Power Act by the FERC as to rates and charges in connection with the transmission of electric energy in interstate commerce, the issuance of debt securities maturing in not more than 12 months, accounting and depreciation policies, interaction with affiliates, and certain other matters. The FERC has declared us exempt from the Natural Gas Act and related FERC orders, rules and regulations.

Our retail natural gas sales also are regulated by the ICC. Such sales are currently priced under a purchased gas adjustment mechanism under which our gas purchase costs are passed through to our customers if such costs are determined prudent.

Employees

At September 30, 2002, we had 607 salaried employees and 1,285 bargaining unit employees. We are subject to collective bargaining agreements with each of the following unions: International Brotherhood of Electrical Workers, Laborers International Union of North America, United Association of Journeymen Plumbers and Gas Fitters and International Association of Machinists and Aerospace Workers. We consider relations with both bargaining unit and salaried employees to be satisfactory.

Properties

As discussed above, we transferred or sold all of our wholly owned generating assets during 1999 and, therefore, did not own any such properties in 2000 or 2001. We continue to own 50% of three peaking diesel combustion turbine units, located in Bloomington, Illinois, with combined net capacity of 5,250 kW. State Farm Insurance Company owns the other 50% of these standby units.

We currently own, but have contracted to sell to Trans-Elect as described above, an electric transmission system of 1,687 circuit miles, operating from 138,000 to 345,000 volts. We also own a distribution system that includes 37,708 circuit miles of overhead and underground lines. All of our properties are located in the State of Illinois.

We own 755 miles of gas transmission pipeline and 7,543 miles of natural gas distribution pipe.

MANAGEMENT

The following table sets forth certain information with respect to our current directors and executive officers:

<u>Name</u>	<u>Age*</u>	<u>Position(s)</u>	<u>Served with Illinois Power Since</u>
Larry F. Altenbaumer	54	Chief Executive Officer, President and Director	1970
Peggy E. Carter	39	Vice President and Controller	1985
Michael R. Mott	42	Senior Vice President	2002
Kathryn L. Patton	38	Senior Vice President, General Counsel and Secretary	2000
Daniel L. Dienstbier	62	Director	2002
Kenneth E. Randolph	46	Director	2000
Bruce A. Williamson	43	Director	2002

* As of September 30, 2002.

Larry F. Altenbaumer has served as our Chief Executive Officer since October 2002 and as our President since September 1999. Mr. Altenbaumer has served as a director of Illinois Power and as Senior Vice President of Dynegy since February 2000, following the consummation of the Dynegy-Illinova merger. Mr. Altenbaumer previously served as Senior Vice President and Chief Financial Officer of Illinois Power from 1992 until September 1999 and as Senior Vice President, Chief Financial Officer, Treasurer and Controller of Illinova from June 1994 until September 1999.

Peggy E. Carter has served as our Vice President since February 2000 and as our Controller since November 1999. Ms. Carter was elected to serve as Vice President of Illinois Power following the consummation of the Dynegy-Illinova merger. Ms. Carter previously served Illinois Power in various capacities from 1985, including Business Leader in Illinois Power's accounting department from August 1994 until November 1999.

Michael R. Mott has served as our Senior Vice President since November 2002. Mr. Mott also serves as Chief Accounting Officer, Senior Vice President and Controller of Dynegy. Mr. Mott joined Dynegy in 1995 as Director of Financial Reporting and was appointed to Vice President and Assistant Controller in January 2000. Mr. Mott has served as Senior Vice President and Controller of Dynegy since March 2001 and as Chief Accounting Officer since August 2002. Prior to joining Dynegy, Mr. Mott was employed by Price Waterhouse.

Kathryn L. Patton has served as our General Counsel and Secretary since February 2000, following the consummation of the Dynegy-Illinova merger. Ms. Patton also has served as Senior Vice President of Illinois Power and Vice President and Assistant General Counsel of Dynegy since July 2001, prior to which she served as Vice President of Illinois Power from February 2000 to July 2001. Ms. Patton previously served Dynegy as Director and Regulatory Counsel from May 1995 to March 1999 and Senior Director and Regulatory Counsel from March 1999 until February 2000.

Daniel L. Dienstbier has served as a director of Illinois Power since June 2002 and as a director of Dynegy since 1995. He has served as Dynegy's Chairman of the Board since September 2002 and served as its interim Chief Executive Officer from May 2002 to October 2002. He has over thirty years of experience in the oil and gas industry. He served as President and Chief Operating Officer of American Oil & Gas Corp. from October 1993 through July 1994, President and Chief Operating Officer of Arkla, Inc. from July 1992 through

October 1993, and President of Jule, Inc., a private company involved in energy consulting and joint venture investments in the pipeline, gathering and exploration and production industries, from February 1991 through June 1992. Prior thereto, Mr. Dienstbier served as President and Chief Executive Officer of Dyco Petroleum Corp., and Executive Vice President of Diversified Energy from February 1989 through February 1991. In addition, he served as President of the Gas Pipeline Group of Enron Corp. from July 1985 through July 1988. Mr. Dienstbier is a former director of American Oil & Gas Corp., Arkla, Inc., Enron Corp. and Midwest Resources, and a former member of the Audit Committee of Northern Border Partners, L.P.

Kenneth E. Randolph has served as a director of Illinois Power since February 2000, following the consummation of the Dynegy-Illinova merger. Mr. Randolph also serves as Executive Vice President and General Counsel of Dynegy. He has served as Executive Vice President of Dynegy since July 2001 and as General Counsel of Dynegy and its predecessor, Natural Gas Clearinghouse, referred to as "Clearinghouse," since July 1987. In addition, he served as a member of the Clearinghouse Management Committee from May 1989 through February 1994 and managed its marketing operations in the Western and Northwestern United States from July 1984 through July 1987. Prior to his employment with Clearinghouse, Mr. Randolph was associated with the Washington, D.C. office of Akin, Gump, Strauss, Hauer & Feld, L.L.P.

Bruce A. Williamson has served as a director of Illinois Power since November 2002. Mr. Williamson also serves as President and Chief Executive Officer and as a director of Dynegy. Prior to joining Dynegy in October 2002, Mr. Williamson served as President and Chief Executive Officer of Duke Energy Global Markets. Prior to serving as President and Chief Executive Officer of Duke Energy Global Markets, Mr. Williamson served as President and Chief Executive Officer of Duke Energy International since 1997. Following the Duke Power and PanEnergy Corporation merger in 1997, Mr. Williamson was senior vice president of business development and risk management. Prior to the merger, Mr. Williamson served as vice president of finance for PanEnergy where he was responsible for corporate development, corporate-wide commodity risk management and strategic oversight of corporate treasury. Before joining PanEnergy, Mr. Williamson held positions of increasing responsibility at Royal Dutch/Shell Group, advancing over a 14-year period to assistant treasurer of Shell Oil Company.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

All of our common stock is owned by Illinova Corporation, which is a wholly owned subsidiary of Dynegy Inc. A subsidiary of ChevronTexaco Corporation holds approximately 26.5% of Dynegy's outstanding common stock and \$1.5 billion of its Series B Mandatorily Convertible Redeemable Preferred Stock. We also have six series of preferred stock outstanding, 73% of which is owned by Illinova.

Effective October 1, 1999, we transferred our wholly owned fossil generating assets and other generation-related assets and liabilities at net book value to Illinova in exchange for an unsecured note receivable of approximately \$2.8 billion. Such assets were subsequently contributed by Illinova to Illinova Power Marketing Inc., an Illinova subsidiary. Following the Dynegy-Illinova merger, Illinova Power Marketing was renamed Dynegy Midwest Generation and was sold by Illinova to Dynegy Inc. Dynegy subsequently contributed DMG to Dynegy Holdings Inc., a Dynegy subsidiary. Effective August 31, 2001, approximately \$9 million of additional fossil generation-related assets were transferred to Illinova, and concurrently to DMG, and the unsecured note receivable was adjusted accordingly. The note matures on September 30, 2009 and bears interest at an annual rate of 7.5%, due semiannually in April and October. At September 30, 2002, principal outstanding under the note receivable approximated \$2.3 billion with no accrued interest due to the July 2002 prepayment of interest due October 1, 2002 of approximately \$85 million. In each of September and November 2002, Illinova prepaid interest of approximately \$14 million on the note receivable for the months of October and November 2002, which interest was otherwise due in April 2003. We recognized approximately \$128 million of interest income from Illinova on the note for the first nine months of 2002. We recognized approximately \$127 million of interest income from Illinova on the note for the first nine months of 2001. In the fourth quarter of 2001, Illinova accelerated the payment of accrued interest on the note receivable for the three months ended December 31, 2001 in the amount of \$43 million.

We routinely conduct business with subsidiaries of Dynegy. These transactions include the purchase or sale of electricity, natural gas and transmission services as well as certain other services. Operating revenue derived from transactions with affiliates approximated \$26 million for the nine months ended September 30, 2002. Operating revenue derived from transactions with affiliates approximated \$27 million for the nine months ended September 30, 2001. Operating revenue derived from transactions with affiliates approximated \$32 million for 2001 and \$40 million for 2000. Aggregate operating expenses charged by affiliates approximated \$403 million for the nine months ended September 30, 2002, including \$369 million for power purchased. Aggregate operating expenses charged by affiliates approximated \$410 million for the nine months ended September 30, 2001, including \$349 million for power purchased. Aggregate operating expenses charged by affiliates in 2001 approximated \$527 million, including \$460 million for power purchased. Aggregate operating expenses charged by affiliates in 2000 approximated \$628 million, including \$558 million for power purchased.

We have a power purchase agreement with DMG that provides us the right to purchase power from DMG for a primary term extending through December 31, 2004. The primary term may be extended on an annual basis, subject to concurrence by both parties and regulatory approvals. The power purchase agreement defines the terms and conditions under which DMG provides power and energy to us using a tiered pricing structure. With this arrangement, we believe we have an adequate power supply for our expected load plus a reserve supply above that expected level. The power purchase agreement obligates DMG to provide power, at the same prices, up to the reservation amount, even if DMG has individual units unavailable at various times. Should power acquired under this agreement be insufficient to meet our load requirements, we will have to buy power from third parties at current market prices.

Effective January 1, 2000, the Dynegy consolidated group, which includes us, began operating under a Services and Facilities Agreement whereby other Dynegy affiliates exchange services with us such as financial, legal, information technology and human resources as well as shared facility space. Our services are exchanged at fully distributed costs and revenue is not recorded under this agreement. We believe that the allocation method utilized under this agreement is reasonable and amounts charged under this agreement would result in costs to us

similar to costs we would have incurred for these services on a stand-alone basis. This agreement also includes tax sharing provisions between us and Dynegy. The Services and Facilities Agreement can be terminated by either party on 30 days' notice, subject to ICC approval.

On October 23, 2002, the ICC issued an order approving a petition submitted by us to enter into an agreement with Dynegy and its affiliates that would allow for certain payments due to Dynegy under the Services and Facilities Agreement to be netted against certain payments due to us from Dynegy, should Dynegy or its affiliates fail to make payments due to us on or before their due dates. The agreement also allows Dynegy to net payments in the event we fail to make our required payments to Dynegy. Additionally, under the terms of this petition and the ICC's approval, we may not pay any common dividend to Dynegy or its affiliates until our Mortgage Bonds are rated investment grade by Moody's and Standard & Poor's and specific approval is obtained from the ICC. The ICC also granted our request, subject to certain conditions, to advance funds to service interest on Illinova's senior notes in February 2003 if Dynegy is not able to make such payments and to repurchase our preferred stock held by Illinova in order to provide funds to pay interest on Illinova's senior notes due in August 2003 and February 2004 if Dynegy is unable to make such payments. Please read the risk factor titled "We are particularly susceptible to developments at Dynegy because we rely on an unsecured note receivable from Illinova for a substantial portion of our net cash provided by operating activities" for further discussion.

DESCRIPTION OF THE OFFERED BONDS

We are issuing the Offered Bonds under our General Mortgage Indenture and Deed of Trust dated as of November 1, 1992 (the "Mortgage") between us and BNY Midwest Trust Company, as successor trustee to Harris Trust and Savings Bank (the "Trustee"), as supplemented by various supplemental indentures, including the supplemental indenture relating to the Offered Bonds (the "Supplemental Indenture"). The Offered Bonds will be secured by the lien of the Mortgage on our properties used or to be used in the generation, purchase, transmission, distribution and sale of electricity and natural gas. Please read "— Security."

The following summaries do not purport to be complete and are subject to, and are qualified in their entirety by reference to, the Trust Indenture Act of 1939 (the "Trust Indenture Act"), the Offered Bonds, the Mortgage and the Supplemental Indenture. We urge you to read the Mortgage and the Supplemental Indenture because they, and not this description, define your rights as holders of the Offered Bonds.

The Offered Bonds have not been registered under the Securities Act and are subject to transfer restrictions. When issued, the Offered Bonds will be a new issue of securities with no established trading market. No assurance can be given as to the liquidity of the trading market for the Offered Bonds.

This description makes use of defined terms in the Mortgage and the Supplemental Indenture.

Dates of Issue; Escrow of Proceeds of Delayed Delivery Bonds

Offered Bonds in the aggregate principal amount of \$400,000,000 (the "Initial Delivery Bonds") will be issued and delivered, against payment of the issue price by the initial purchasers, on or about December 20, 2002, and, subject to approval of the ICC, the Delayed Delivery Bonds will be issued and delivered on or before January 31, 2003.

At the closing of this offering on or about December 20, 2002, the initial purchasers will place into escrow the net proceeds of the offering of the Delayed Delivery Bonds (after deducting the initial purchasers' discount with respect to the Delayed Delivery Bonds but without deducting any expenses of the offering), pursuant to an Escrow Agreement with BNY Midwest Trust Company, as escrow agent (the "Escrow Agent"). The escrowed funds will be held by the Escrow Agent pursuant to the Escrow Agreement. While in escrow, the escrowed funds will be invested in temporary cash investments at the direction, and for the account, of the initial purchasers.

If the Escrow Agent receives notice from us and the initial purchasers by January 31, 2003 that the ICC has approved the issuance of the Delayed Delivery Bonds, then the Escrow Agent will release all escrowed funds to the initial purchasers upon delivery of an officer's certificate certifying that we have received such approval, and, concurrently with the release of such funds, we will issue the Delayed Delivery Bonds and deliver them to the initial purchasers, against payment to us of the issue price (plus an amount equal to the earnings on the escrowed funds paid over to the initial purchasers by the Escrow Agent but without accrued interest on the Delayed Delivery Bonds). We will have no rights to any escrowed funds prior to such a release.

If the Escrow Agent has not received the notice from us and the initial purchasers referred to in the preceding paragraph by January 31, 2003, then it will release all escrowed funds (including any amounts earned thereon) to the initial purchasers and we will pay to the initial purchasers, for the benefit of the purchasers of the Offered Bonds, an amount equal to the interest that would have accrued on the Delayed Delivery Bonds had they been issued on December 20, 2002 less the earnings on the escrowed funds. The initial purchasers will then remit to the purchasers of the Offered Bonds such purchasers' pro rata portions of these funds together with an amount equal to their pro rata portions of the initial purchasers' discount, which amount had previously been retained by the initial purchasers. We will have no responsibility for the return of these funds to such purchasers.